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IN THE

Supreme Court of the United States

OCTOBER TERM, 1998

INDIANAPOLIS POWER & LIGHT COMPANY,

Petitioner,

vs.

PENNSYLVANIA PUBLIC UTILITY COMMISSION and PECO ENERGY COMPANY, *et al.*,

Respondents.

On Petition for Writ of Certiorari to the Commonwealth Court of Pennsylvania

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REASONS ON REPLY FOR GRANTING THE WRIT

The Commerce Clause issue framed by the Pennsylvania Act is straightforward. The Act opens the State's retail electric generation market to interstate competition, but requires all customers to pay a surcharge to subsidize incumbent, formerly monopoly Pennsylvania producers for uneconomic generation costs they cannot recover at competitive market prices. Respondents (including the Commission that prepared the Act) have said the purpose of this "stranded cost" subsidy is to "level the playing field" for in-state producers in competing with out-of-state producers. This Court's Commerce Clause precedents are equally clear. Discriminatory state regulation whose purpose or effect is to "enable higher cost [in-state producers] to compete with lower cost [producers] in other States" — thereby "neutralizing the advantage possessed by lower cost out-of-state producers" — is "clearly unconstitutional." *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 194 (1994).

PECO and the Commission resist *certiorari* with a flurry of assertions, all seeking to obscure the Act's obvious — and obviously discriminatory — purpose and effect. In a further effort to evade Commerce Clause scrutiny, PECO introduces novel "standing" theories that would automatically insulate the Act (or comparable discrimination by any State) from this Court's review. Respondents also ignore that parties *defending* such discrimination bear the burden of proving that the State has a legitimate objective that cannot be achieved by alternative, non-discriminatory means.

Respondents' arguments cannot conceal the core reality at the heart of this case. A State at the vanguard of a new field of interstate commerce, involving a vital product in universal demand, has purposefully chosen to discriminate in favor of its incumbent domestic producers. That choice is blessed in a reported appellate decision, which declares that State regulation of this developing interstate commercial arena lies in a "Commerce Clause free" zone. As the States launch their different regulatory experiments in a dawning era of interstate competition for retail electricity, this case poses a simple but critical question: Is discrimination favoring a State's own participants in that competition a constitutionally permissible ingredient in the experiment? Over 150 years of Commerce Clause jurisprudence leave no doubt this question merits an answer from this Court, and that the answer should be "no."

I. The Pennsylvania Act's "Stranded Cost" Provisions, Which Purposefully Subsidize Incumbent In-State Producers In Competition With Out-Of-State Producers, Unquestionably Discriminate Against Interstate Commerce.

Respondents' assorted pretenses that the Act does not discriminate against interstate commerce cannot be credited. The entities who receive "stranded cost" subsidies are incumbent, formerly monopoly producers located in Pennsylvania who generate electricity in that State. The purpose of the subsidies, as both respondents have repeatedly stated, is to "level the playing field" for such high-cost Pennsylvania producers in competition with lower-cost out-of-State producers.[1]

Respondents say the Act does not discriminate against interstate commerce because other, non-subsidized Pennsylvania suppliers are also handicapped. This is insupportable. This Court has roundly rejected any such thesis (even when, unlike here, the discrimination does not favor the largest in-state producers). *E.g., C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 389, 391 (1994) (invalidating regulation favoring a single local company and handicapping all other in-state and out-of-state competitors); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 265, 272 (1984) (invalidating special tax exemption for only two of many locally produced alcoholic beverages). As this Court unanimously held in *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 276-77 (1988), "[v]arying the strength of the bar against economic protectionism according to the size and number of in-state and out-of-state firms affected would serve no purpose except the creation of new uncertainties in an already complex field."[2]

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1. *E.g.*, Definitive Form Brief for Respondent Commission at 15 (purpose of stranded cost provisions is to "level[ ] the playing field" so high-cost Pennsylvania generators "can compete in an open market for generation"); Commission's Brief in Opposition to Petition for Allowance of Appeal at 18 (same); Brief for Intervenor PECO Energy Company (Definitive Text) at 6 (stranded costs provisions "assure[ ] that there will be a 'level playing field' between the former monopoly utilities and all other potential generators, whether in-state or out-of-state"); *id.* at 8 (provisions "level[ ] the competitive playing field . . . [for] Pennsylvania electric utilities"); *id.* at 22 (provisions "create[ ] a level playing field for interstate competition"); *id.* at 25 (same); *id.* at 27 (same).

2. PECO's companion notion — that the Act does not discriminate against interstate commerce because stranded cost subsidies are not confined to former monopoly generators *incorporated* in Pennsylvania or *owned* by Pennsylvania shareholders (Br. 5) — is also insupportable. The discriminatory subsidies are patently (Cont'd)

PECO also suggests that existence of discrimination somehow turns on "fact" issues supposedly resolved against IPL below. *See* PECO Br. 12-13 & n.13 (saying "recovery of stranded costs does not . . . advance incumbent utilities' competitive position," and claiming "ample evidentiary support for PECO's contention" that "stranded cost proceeds" could not be used "for anticompetitive purposes.") This remarkable suggestion — from a party that repeatedly told the lower court the stranded cost provisions "level the playing field" for high-cost Pennsylvania producers — survives not an instant's scrutiny. To note the most obvious dispositive rejoinder, the Commission *did not find* that stranded cost recovery for PECO has no effect on competition. To the contrary, the Commission (which cited the same "level playing field" purpose) explicitly found that use of even a few days' interest income (or "float") on stranded cost proceeds would give PECO a competitive advantage. Pet. App. 111a.

PECO's "low entry barriers and low marginal pricing" contentions (Br. 13) would be of no Commerce Clause moment in any event. This Court has noted that even in the (unlikely) event a discriminatory state tax had no effect on out-of-state competitors' net revenues or costs, it would still cause "comparative economic injury" by "enab[ling] the favored [in-state competitors] alone to derive an increase in total revenue. . . ." *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18, 48 & n.32 (1990).[3]

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an attempt to induce generation of retail electricity within Pennsylvania, when that activity could more efficiently be performed elsewhere. This is a core Commerce Clause violation. *E.g., West Lynn Creamery*, 512 U.S. at 193-94; *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 406 (1984); *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 336 (1977). It is absurd to suggest, for example, that this Court's analysis in *West Lynn Creamery* — which struck down "premium" payments that discriminatorily subsidized Massachusetts milk producers — would have differed because a particular milk producer operating in Massachusetts may have been a New Hampshire corporation with Vermont shareholders.

3. As part of its conjuring on "factual findings," PECO also represents that the Commission

> considered and rejected the argument that PECO's recovery of stranded costs would *discriminate against other suppliers* and would *impose an impermissible burden on interstate commerce*, concluding that "[t]here is simply no factual basis upon which to make such a determination." Pet. App. 63a.

Br. 6 (emphasis added). Perusal of "Pet. App. 63a" shows the Commission made *no*
(Cont'd)

PECO also asserts there is no discrimination because it and out-of-state competitors are not "'substantially similar entities.'" Br. 13, quoting *General Motors Corp. v. Tracy*, 519 U.S. 278, 298 (1997). Not so. The "dissimilar" parties in *Tracy* were (1) regulated monopoly LDCs primarily serving captive residential customers, and (2) out-of-state suppliers whose limited competition with LDCs was confined to a separate market comprising business customers. *See* 519 U.S. at 297-302; Pet. 15-16. Here, PECO and out-of-state generators are *identically situated* as non-monopoly competitors in a single, open market for electricity generation for all retail customers, none of whom is legally "captive" to any generator.[4]

II. PECO's Meritless "Standing" Theories Are A Blueprint For Insulating Discriminatory Schemes Like Pennsylvania's From This Court's Review.

PECO's "standing" notions are notable primarily for "Catch 22" reasoning that would effectively immunize from this Court's review both the Act here and any discriminatory state scheme that follows the Pennsylvania model. PECO first asserts that IPL is not a party "injured" by Pennsylvania's discriminatory subsidies for its in-state generators. However, the Commission rejected PECO's standing challenge, ruling:

> [T]he Act requires this Commission to foster a competitive retail generation market. Therefore, any participant in this future market has a direct interest in the structure and rules of that market. As the owner of generation resources which it may sell

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finding on either italicized factor. Indeed, the Commerce Clause argument of the Environmentalists the Commission was addressing — an argument comprising two paragraphs and a footnote, RR. 224a-227a — did not even mention "discriminat[ion]" or "burden on interstate commerce." Even if the Commission had assayed a "factual finding" of "no discrimination," discrimination against interstate commerce is a *legal* issue determined primarily on the basis of the state law involved.

4. This is underscored by the fact that PECO's claims to be "dissimilar" (Br. 13) do not require subsidizing its uneconomic *generation* costs. *E.g.*, PECO's obligation to serve "low income" customers is underwritten by a *separate* surcharge elsewhere in the Act. Its "distribution and transmission services" are regulated monopoly functions (compensated by regulated monopoly rates), which entail no generation costs and are expressly "unbundled" from competitive generation of retail electricity. As to "provider of last resort" duties, the Act is explicit that the "provider" (1) need not be the *generator* (but may simply purchase and provide electricity generated by others), and (2) need not necessarily be the incumbent Pennsylvania utility. *See* Pet. 2, 27.

> in the Commonwealth, IP&L has a direct interest in this proceeding.

Pet. App. 45a. PECO then did not even contest standing in the state courts.

But PECO claims IPL has now lost standing, saying it "has not demonstrated an 'imminent' threat" of injury because it is not currently competing in the Pennsylvania retail generation market. Br. 20. Specifically, PECO asserts that (1) under the Act, retail "generation competition in Pennsylvania commenced on January 1, 1999" — *i.e., after* IPL's petition for *certiorari* was filed; (2) "IPL has not filed an application with the [Commission] to do business in Pennsylvania"; and (3) "more than 75 entities" have filed such applications, and "many" of them "began providing service" to Pennsylvania customers "on January 1, 1999." Br. 20 n.20. "[T]herefore," says PECO, it is "no answer for IPL to say that it is unwilling to commit resources to competing in Pennsylvania as long as the 'unfair' stranded [cost] rules are in place." *Id.*

On its own terms, this is a *non sequitur*. IPL does not somehow "lose" its standing to challenge the Commerce Clause violation based on the supposed willingness of other "entities" to proceed under unconstitutional conditions. Furthermore, PECO's extra-record assertions about "many" unidentified "entities" who entered the Pennsylvania retail electricity market some five weeks ago — and its implication about their "[willingness] to commit resources to competing in Pennsylvania [with] the 'unfair' stranded [cost] rules . . . in place" — wholly ignore the difference between electric generation *producers* and generation *resellers*. Competitors who directly or in effect merely purchase generation and resell it to retail customers under the Act — such as "brokers," "marketers" and "aggregators," 66 PA. CONS. STAT. § 2809(a), (f) (Pet. App. 192a, 196a) — are *not* directly affected by the discriminatory stranded cost subsidies for high-cost incumbent Pennsylvania generators. The unconstitutional discrimination, in both purpose and effect, is against low-cost, out-of-state generation *producers* like IPL.

The "injury" prong of PECO's standing thesis fails in any event under this Court's precedents, which require only a "sufficient likelihood of economic injury. . . ." *Clinton v. City of New York*, 118 S. Ct. 2091, 2100 (1998).

> The Court routinely recognizes probable economic injury resulting from [governmental actions] that alter competitive conditions as sufficient to satisfy the [Article III 'injury-in-fact'

> requirement] . . . . It follows logically that any . . . petitioner who is likely to suffer economic injury as a result of [governmental action] that changes market conditions satisfies this part of the standing test.

Id. (ellipses and brackets added by Court), quoting 3 K. DAVIS & R. PIERCE, ADMINISTRATIVE LAW TREATISE 13-14 (3d ed. 1994). As the Commission ruled, IPL satisfies that test here.[5]

PECO also says (Br. 20-21) that IPL "has not demonstrated an 'imminent' threat . . . that PECO would use stranded cost recovery 'to sell power well below PECO's cost.'" This is unintelligible. The whole point of the stranded cost provisions is to require Pennsylvania retail generation customers to pay PECO (and other in-state incumbents) a surcharge representing the difference between their (higher) generation costs and the (lower) competitive price for generation. Hence, in the competitive market PECO will by definition "sell power well below PECO's cost." Were that not so, there would be no consumer surcharge.

The underlying notion of PECO's "injury" thesis is that a party injured by a State's erecting a discriminatory barrier to entry into a newly created interstate market must, during the pendency of its challenge, proceed to enter that new market as a precondition to this Court's review of the very unconstitutional barrier that makes its entry pointless. The same "Catch 22" reasoning is all but explicit in the second prong of PECO's thesis, prompted by the Commonwealth Court's alternative holding that the Electric Generation Act is not severable — *i.e.*, that if the stranded cost provisions are unconstitutional, the entire Act must fall. Pet. App. 33a-36a. From this, PECO suggests (Br. 21) that IPL lacks standing because, if its challenge succeeds, there will be no competitive retail generation market in Pennsylvania for IPL (and all other potential competitors) to enter.

This is too cute by half. As this Court has repeatedly noted in Equal Protection Clause cases, an unconstitutional inequality often can be remedied by either extending a benefit to plaintiff or withdrawing it from others (or by either relieving plaintiff of a burden or imposing it on others). Notwithstanding

5. Like appellees in *Clinton*, IPL's "injury in this regard is [also] at least as concrete as the injury suffered by the respondents in *Bryant v. Yellen*, 447 U.S. 352 (1980)." 118 S. Ct. at 2100. *See id.* at 2100-01 (prospective land purchasers in *Bryant* had standing "'even though they could not with certainty establish that they would be able to purchase excess lands' if the [challenged] judgment were reversed, . . . because it was 'likely that excess lands would become available at less than market prices'") (quoting 447 U.S. at 367, 368).

that invalidation of the inequality therefore may not result in plaintiff's obtaining the benefit (or being relieved of the burden), the Court "has nonetheless consistently upheld plaintiffs' standing." R. FALLON, D. MELTZER & D. SHAPIRO, HART AND WECHSLER'S THE FEDERAL COURTS AND THE FEDERAL SYSTEM 150 (4th ed. 1996) ("HART & WECHSLER"), citing *inter alia Heckler v. Mathews*, 465 U.S. 728 (1984), and *Orr v. Orr*, 440 U.S. 268 (1979).[6]

Heckler is directly in point. There, Congress provided that if a statutory discrimination extending a benefit to some were invalidated, the entire benefit provision should fall — thus assuring that anyone challenging the discrimination could never obtain the benefit. This Court held the statutory non-severability provision (and result) could not divest a plaintiff's standing. 465 U.S. at 734-41. That decision "is surely sound; to have denied standing would have effectively immunized the statute from judicial review." HART & WECHSLER at 151. The state court below, *via* its non-severability holding, attempts the same immunization of Pennsylvania's discrimination against interstate commerce. *See* Pet. App. 33a-34a. The tactic deserves no more success here than in *Heckler*.

III. Respondents Bear The Burden Of Proving That The State Had No Alternative Means To Achieve Any "Interests" Purportedly Served By The Act's Discriminatory Stranded Cost Subsidies.

PECO argues (Br. 16-17) that IPL did not present sufficient "evidence" on the "divestiture alternative." The Commission (Br. 23) concurs. This supposed "fact" issue is a transparent attempt to change the law. This Court has held time and again that parties *defending* a discriminatory state law bear the burden of proving the State has no alternative means to achieve a legitimate (*i.e.*, non-protectionist) interest. *E.g., C & A Carbone*, 511 U.S. at 392; *Oregon Waste Sys., Inc. v. Department of Envtl. Quality*, 511 U.S. 93, 100-01 (1994); *New Energy Co.*, 486 U.S. at 278. Here, respondents wholly failed to carry that burden. Among other things, PECO presented no evidence to support its counter-intuitive argument (Br. 16-17) that divestiture would result in "less competition" in the competitive generation market.[7]

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6. Similarly, this Court has noted in the Commerce Clause context that an unconstitutionally discriminatory state tax may be remedied by either refunding plaintiff's tax payments or imposing the tax on the in-state competitors. *McKesson Corp.*, 496 U.S. at 39-41.

7. In representing to this Court the extent of "the record developed by IPL on the divestiture alternative" (Br. 17 n.17), PECO also overlooks the report of the New

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PECO also says IPL "apparently" challenges only "the *amount* of stranded cost recovery" — from which PECO tries to extract an inference that the stranded cost provisions necessarily do not "violate[ ] constitutional norms as a matter of law." Br. 15 (emphasis original). PECO's premise that IPL challenges only "amount" purportedly derives from IPL's acknowledgment that factors such as "nuclear decommissioning" are "valid local interests." Br. 14. This blatantly ignores IPL's actual (and dispositive) Commerce Clause arguments as to such state "interests." The first and most basic point remains that all such interests could be achieved by conditioning recovery of stranded generation costs on divestiture of the generation business — and certainly PECO, who has the burden of proof on the issue, did nothing to show otherwise. Pet. 24-26. As IPL also pointed out, the discriminatory stranded cost provisions could not in any event be justified by such state interests, because the subsidies given the incumbent Pennsylvania utilities are not limited to amounts necessary to achieve those interests (if any). Pet. 26-27.[8]

IV. Congress Has Neither Authorized The States To Impose Discriminatory Stranded Cost Schemes, Nor Given FERC Any Authority To Grant Such Supposed "Authorization."

Embellishing the state court's refrain that the Commerce Clause is "not involve[d]" (*e.g.*, Pet. App. 12a, 16a), the Commission reprises (Br. 17) its theory that, "[g]iven" various "determinations" by FERC in regulating at the wholesale level, "Pennsylvania has federal imprimatur to provide for recovery of [stranded] costs and, therefore, the dormant Commerce Clause is not triggered." This ignores that any "imprimatur" for state discrimination must come from *Congress*; that it must be "expressly stated," "unmistakably clear," and "unambiguous"; and that this Court has *twice* held that the Federal Power

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Hampshire Public Utilities Commission, introduced as an exhibit, which concluded *inter alia* that "government-mandated stranded cost recovery is inconsistent with effective competition," but "[t]his problem can be avoided by requiring that the assets be sold [*i.e.*, divested] prior to the introduction of competition so that the incumbent does not end up with both the cash and the paid-off asset." RR. 350a.

8. PECO's misleading premise that IPL challenges only the stranded cost "*amount*" also purports to be based (Br. 15) on a selective, out-of-context quotation of IPL witness testimony. That testimony, also reprinted selectively and out-of-context in PECO App. 30a, is not even in the Reproduced Record submitted to the court below. Further, the scarcely intelligible snippet PECO reprints in fact relates to both a definition and a treatment of "stranded costs" wholly different from the discriminatory Pennsylvania version at issue here.

Act does *not* authorize State regulation that would otherwise violate the dormant Commerce Clause. *See* Pet. 14-15 (citing cases).

The Commission's thesis also ignores that Congress has refuted any notion that FERC can stamp discriminatory state retail regulation with a "federal imprimatur." FERC authority to order wholesale "wheeling" — *i.e.*, requiring monopoly transmission and distribution facilities to be made available for competitors in the generation market — was conferred by the 1992 Energy Policy Act amendments to the Federal Power Act (pertinent provisions codified at 16 U.S.C. §§ 824j-824k). The Conference Report makes clear that FERC's authority as to wholesale competition has *no* effect on the validity *vel non* of State retail regulation:

> New section 212(h) of the Federal Power Act contains a *savings* clause for State laws dealing with retail wheeling. Thus, State laws that either prohibit or permit retail wheeling *are unaffect[ed]* by this subsection[, a]nd, *if otherwise valid*, remain in full force and effect.

H.R. CONF. REP. No. 102-1018 at 388, *reprinted in* 1992 U.S.C.C.A.N. 2472, 2479 (emphasis added). *See Sporhase v. Nebraska* ex rel. *Douglas*, 458 U.S. 941, 959-60 (1982) (even when federal statutes reflect "deference" to state law, "[t]he negative implications of the Commerce Clause . . . are ingredients of the *valid* state law to which Congress has deferred") (emphasis original).[9]

CONCLUSION

Respondents' chorus throughout is that since Pennsylvania is opening competition where none existed before, "fairness" demands that it be permitted to "compensate" its incumbent in-state producers for uneconomic costs allegedly attributable to their former status as regulated monopolists. But no non-protectionist "interest" in compensation requires conferring discriminatory subsidies on these in-state producers as competitors in an open interstate market. Divestiture fully achieves any compensation objective. Pennsylvania has no legitimate "state interest" to insist that formerly monopoly in-state generators must participate in a market it opens to interstate

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9. The Commission's discourse on federal law also includes the astounding suggestion (Br. 10-11 n.10) that "the constitutionality of stranded cost recovery could reach this court through appeals" of FERC regulatory action, and that "a federal regulatory proceeding with national implications is the better case to review." To state the obvious, federal regulation is not subject to the dormant Commerce Clause strictures that circumscribe State regulation.

competition, and then further insist that it may "level the playing field" *via* discrimination favoring these domestic participants.

This is so *regardless* of the regulatory or other economic history that supposedly disadvantages domestic competitors and persuades the State's political branches that the interstate playing field "needs" discriminatory leveling. Comparative advantages and disadvantages among competitors from different States never arise in a regulatory or economic vacuum. Cost differentials are always traceable to historical roots, whether planted by nature (*e.g.*, the relative scarcity or abundance of a valuable resource in a given State) or the law (*e.g.*, the impact of a State's environmental or, as in this case, past utility regulation). States have wide experimental latitude in responding to these realities; but discrimination favoring their domestic participants in competitive interstate markets is a beaker that must be left on the laboratory shelf. This is the central principle of this Court's dormant Commerce Clause jurisprudence.

Respondents urge abrogation of that principle, on the ground that the in-state participants' claimed disadvantage here arises from the State's own regulatory history. This "transition from monopoly" refrain is simply this case's version of the standard rationale always put forth to "justify" state discrimination — which is always predicated on particular factors peculiar to the economic context of the particular competitive interstate arena involved. Here, that familiar rationale — blessed by the state court as a legitimate "state interest" justifying discriminatory regulation of retail electricity generation — invites protectionist and retaliatory economic warfare among the States in a vital new field of interstate commerce.

The constitutional question is squarely framed. The answer is of national import. This Court should grant review.

Respectfully submitted,

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